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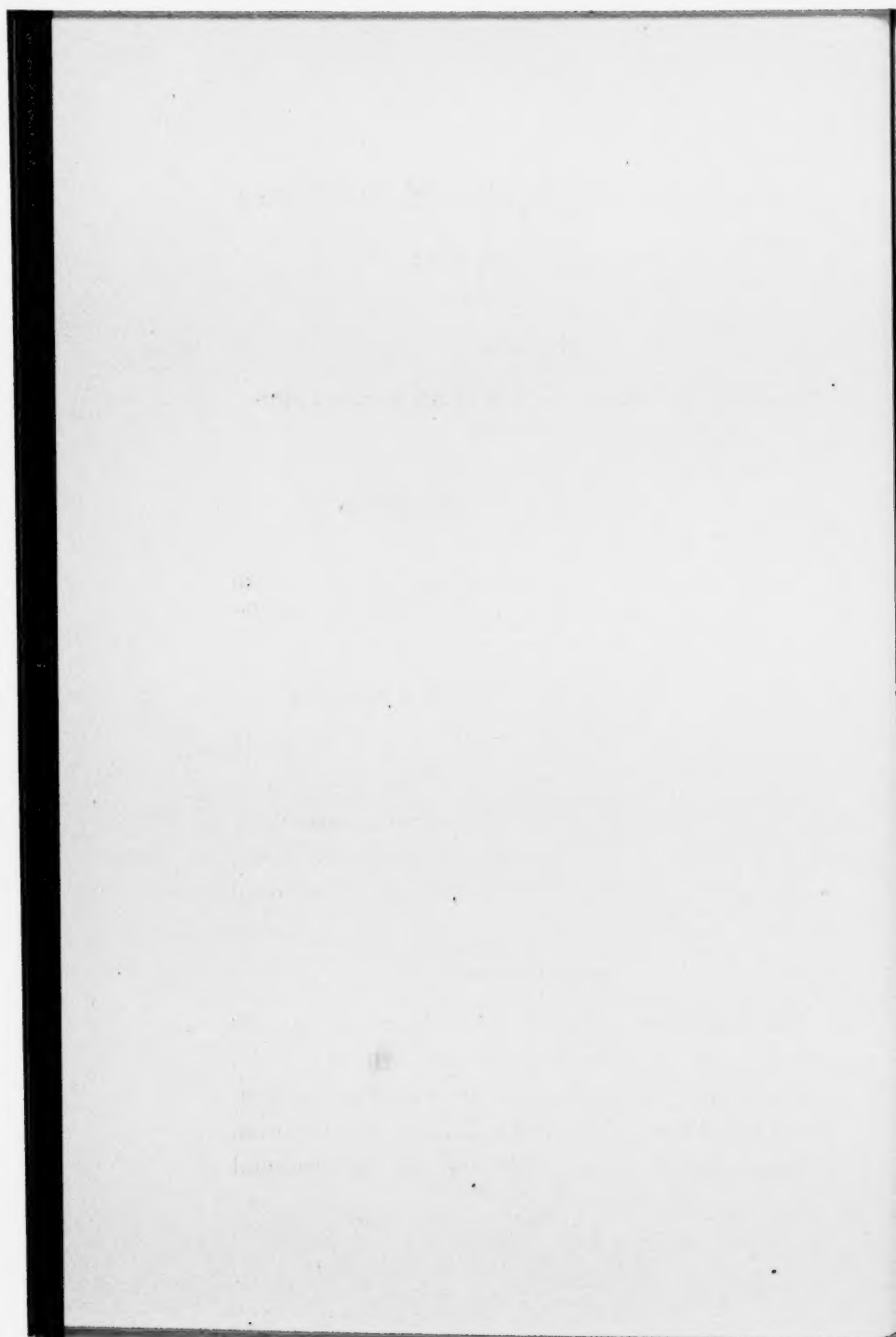
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(1)



In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 436

BOLIVIAN INTERNATIONAL MINING CORPORATION,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SECOND
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 101-108) is reported in 1 T. C. 1110. The memorandum decision of the Circuit Court of Appeals (R. 136), affirming the opinion of the Tax Court, is reported in 142 F. 2d 556.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 7, 1944 (R. 136-137). The petition for a writ of certiorari was filed on September 6, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial

Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. May a deficit in earnings and profits from prior years, existing at the commencement of a given taxable year, be considered in determining the credit allowed under Section 26 (f) of the Revenue Act of 1936, as amended by Section 501 (a) (3) of the Revenue Act of 1942; or, in such event, are the earnings and profits as of the commencement of the taxable year, to be taken as zero?

2. Did taxpayer execute a written contract prior to May 1, 1936, expressly restricting payment of dividends within the meaning of Section 26 (c) (1) of the Revenue Act of 1936?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 15-27.

STATEMENT

The Tax Court's findings of fact may be summarized as follows:

Boltin, Inc., during 1934 and 1935 was a Delaware corporation, the shareholders of which were:

	Shares
Irving W. Bonbright.....	354
O. B. Perry.....	354
George A. Easley.....	185.8
A. G. Dibbs, as nominee for Hubert E. Rogers.....	108.2
	<hr/> 1,000.0

In turn, Boltin, Inc., owned all of the capital stock of taxpayer. In 1935, Bonbright was president, Perry, vice president, one Ericson, secretary, and Dibbs, treasurer of taxpayer. In the same year, Boltin, Inc., was indebted on notes to three of its shareholders, namely, Bonbright, Perry, and Easley in an amount in excess of \$1,000,000. It was not indebted to Rogers. In 1934, a proposed merger of Boltin, Inc., into taxpayer was under discussion between Rogers, Bonbright, and Perry. Easley was present at many of the discussions. Rogers objected to any plan which contemplated paying off the note indebtedness to the other stockholders after the proposed merger before payment of dividends on taxpayer's stock to all its shareholders. (R. 102-103.) On October 14, 1935, Bonbright, in Rogers' presence, wrote the following letter to Perry in San Francisco (R. 103-104):

MY DEAR PERRY:

This morning I am in receipt of your letter of the 10th October; also, of a letter from Rogers in which he accepts, without qualification, the proposed compromise conditions named in my letter to him of the 11th October, a copy of which was sent to you by air mail on that day, together with the original of his letter to me of the 10th October.

* * * * *

Under the plan as now agreed to, subject to your approval, funds of the Company as

made available through the setting aside of depletion reserve, etc., to the extent of \$150,000 per year, will be used toward retirement of the new notes; interest at the rate of $3\frac{1}{2}$ per cent. per annum on said notes will then be paid, and, if additional funds are available, twelve cents per share per annum will be declared in dividends on the approximately 160,000 shares of B. I. M. C. stock. Any funds available in any year, after provision of the items named above, to go toward the future retirement of the notes.

You are correct in your assumption as to what I meant in my letter to Mr. Rogers about "elimination of any stock not required for immediate purposes of the merger." There will be no stock beyond what is required to satisfy the proposed deliveries to Boltin shareholders and the amount required to be held in the treasury for possible conversion of notes.

Before this letter reaches you, you will doubtless have received the correspondence above referred to, namely, Mr. Rogers' letter of October 10th, and copy of my reply of October 11th. And I hope after reading those letters and this one, you will have a clear picture in your mind.

To make sure that all of our minds have met with regard to the points I have covered in this letter, I am sending a copy to Mr. Rogers, and one to Mr. Armitage, and if you do not hear to the contrary by wire, you will know that all here are in agreement. And, in that case, I will be glad to

have you wire your approval in order that Mr. Armitage may proceed without further delay, in the preparation of the final papers.

With kindest regards,

Yours very truly,

IRVING W. BONBRIGHT.

Perry, on October 16, 1935, wired Bonbright (R. 104):

Your letter October fourteenth regarding Boltin Bimco merger stop I approve plan to which your letter refers

O. B. PERRY.

At the time Bonbright's letter was written, he had received the following letter dated October 11, 1935, from Rogers (R. 105):

I have just received your letter of this date.

Your suggested amendments to the plan, as well as to the matter of compensation which you propose, are entirely satisfactory to me.

On December 24, 1935, a formal agreement of merger between Boltin, Inc., and taxpayer, dated December 12, 1935, was executed by the corporations and by a majority of their respective boards of directors constituting practically all the stockholders and creditors, which contained the following provision (*ibid.*):

SEVENTH. All rights of creditors and all liens upon the property of either of said corporations shall be preserved unimpaired, and all debts, liabilities and duties

of BOLTIN, INC., shall thenceforth attach to said BOLIVIAN INTERNATIONAL MINING CORPORATION, the continuing corporation, and may be enforced against it to the same extent as if the said debts, liabilities and duties had been incurred or contracted by it.

On August 14, 1936, the taxpayer's directors adopted the following resolution (R. 105-106):

RESOLVED that in accordance with the terms of the agreement of merger and consolidation of Boltin, Inc., and Bolivian International Mining Corporation, the escrow agreement dated the 10th day of March, 1936, and the stockholders' agreement of October 14, 1935, that a dividend of 12¢ per share be paid on this Corporation's outstanding shares of stock (excluding 100,294 shares of stock deposited with the escrow agent pursuant to the terms of escrow agreement), and that the officers of the Corporation be and they hereby are directed to pay such dividend on the 21st day of August, 1936 to the registered holders of the shares of the Corporation as of the 19th day of August, 1936.

Taxpayer redeemed notes in 1936 and 1937 in the amounts of \$103,838 and \$299,100, respectively, and paid 12 cents per share dividend in both years. No dividends were thereafter paid in excess of that amount. (R. 106.)

The Tax Court found as a fact that taxpayer did not execute a written contract prior to May 1,

1936, which expressly restricted the payment of dividends (*ibid.*).

At the commencement of the taxable year (January 1, 1936), taxpayer had a deficit from prior years in the amount of \$55,305.77. For the year 1936, its adjusted net income was \$75,946.41. Its 1936 earnings and profits as adjusted in the Commissioner's deficiency notice were \$87,984.01. (R. 106.)

ARGUMENT

We submit that the decision below is correct, that there is no conflict and that the questions raised are neither novel nor important.

1. A deficit in accumulated earnings and profits of taxpayer as of the beginning of the taxable year cannot be taken into consideration in determining the credit allowance under Section 26 (f) of the Revenue Act of 1936, as amended by Section 501 (a) (3) of the Revenue Act of 1942 (see Appendix, *infra*, p. 19). Where such deficit exists, earnings and profits, as of the beginning of the taxable year, must be treated as zero. A Treasury Decision¹ specifically regulates the point here in question in accordance with the holding of the court below, and completely dis-

¹ T. D. 5263, 1943 Cum. Bull. 1003, which added Article 26-4 to Treasury Regulation 94 (Appendix, *infra*, pp. 25-27), providing in part:

"If there is a deficit in the accumulated earnings and profits as of the beginning of the taxable year, or for the taxable year, such deficit shall not be taken into consid-

poses of taxpayer's contention. The legislative history of the statute shows that it was designed to aid a corporation whose net income for a given taxable year exceeded accumulated and current earnings because of certain unallowable deductions, such as capital losses, and which, thus, might be subject to the undistributed profits surtax, even though it had distributed all of its accumulated and current earnings.² The Treasury

eration in determining the credit allowable under section 26 (f), and in such a case the earnings and profits as of the beginning of the taxable year, or the earnings and profits of the taxable year, shall be considered as zero."

This Treasury Decision was cited to the court below; apparently it was not before the Tax Court at the time its opinion was rendered. However, the ruling of the Tax Court entirely accords with the regulation.

² See H. Rep. No. 2333, 77th Cong., 2d Sess., p. 170, wherein it is stated that—

"Under section 14 of the Revenue Act of 1936 corporations in general were subject to surtax at various rates from 7 to 27 percent of their undistributed net income, even though such income was in excess of accumulated and current earnings or profits. In such a case the tax could not be avoided even if distributions were made to shareholders. This result was primarily due to the fact that section 117 (d) of the Revenue Act of 1936 limited capital losses to \$2,000 and section 27 (a) and (h) operated to disallow any credit where a distribution did not constitute a taxable dividend. Section 115 of the act provided that the term "dividend" means a distribution from earnings or profits, either those accumulated after February 28, 1913, or those realized during the current taxable year. The purpose of the undistributed profits tax was to force the payment of taxable dividends. Where a corporation has no earnings or profits, it cannot make a taxable dis-

Decision T. D. 5263, Article 26-4, Appendix, *infra*, pp. 25-27) expresses the same interpretation of the statutory intent. To permit taxpayers with accumulated deficits in earnings and profits as of the beginning of a taxable year to obtain a credit by deducting these deficits from the earnings and profits of the current year, would create an arbitrary and aimless discrimination against other taxpayers, not having such deficits. Under such a construction, contrary to the plain intent of the statute, a corporation might claim a credit even though possessed of current earnings, which it could distribute as dividends.³ To the same effect as the instant case is the decision of the Tax Court in *Shellabarger Grain Products Co. v. Commissioner*, 2 T. C. 75, 84, appeal now pending in the Circuit Court of Appeals for the Seventh Circuit.

The decision of the court below in *Van Ameringen-Haebler, Inc. v. Helvering*, 132 F. 2d 855 (Pet. 9, 23, 26) is in no way inconsistent with or even relevant to its holding in the present case.

tribution which would constitute a dividend allowable as a dividend credit in computing the undistributed net income subject to the surtax."

See also S. Rep. No. 1631, 77th Cong., 2d Sess., p. 244.

³ Where a taxpayer is prohibited by law from paying dividends during the existence of a deficit in accumulated earnings and profits, a credit is authorized under Section 26 (c) (3) of the Revenue Act of 1936, as amended by Section 501 of the Revenue Act of 1942 (Appendix, *infra*, p. 18). However, no such claim has ever been made in this case.

There, the court did not construe Section 26 (f), but, on the Commissioner's application, remanded the case to the Tax Court so that it might consider this and the other retroactive amendments which had not been before it on the original hearing.

2. Taxpayer did not execute a written contract prior to May 1, 1936, expressly restricting the payment of dividends within the meaning of Section 26 (c) (1) of the Revenue Act of 1936 (Appendix, *infra*, pp. 16-17). It has repeatedly been held that this Section must be strictly construed, since it grants a special deduction or exemption from a generally imposed surtax (Revenue Act of 1936, Sec. 14, Surtax On Undistributed Profits, Appendix, *infra*, pp. 15-16). *E. g.*, *Helvering v. Northwest Steel Mills*, 311 U. S. 46, 49. Again, since it is a special credit in the nature of a deduction, the taxpayer must sustain the burden of showing compliance with its exact terms (*Helvering v. Ohio Leather Co.*, 317 U. S. 102, 106; *White v. United States*, 305 U. S. 281, 292; *New Colonial Ice Co. v. Helvering*, 292 U. S. 435, 440; *Buffalo Slag Co. v. Commissioner*, 131 F. 2d 625, 626 (C. C. A. 2d); *Commissioner v. Oswego Falls Corp.*, 137 F. 2d 173, 176 (C. C. A. 2d)). The Tax Court, weighing the evidence, found as a fact that taxpayer did not execute a written contract prior to May 1, 1936, which expressly restricted the payment of dividends (R. 106-107). Thus, if, as taxpayer claims, the record contains any contrary evidence

or permits contrary inferences, these have been resolved by the trier of the facts against taxpayer and the finding of the Tax Court that "We can not find from the evidence that there was such a contract" (R. 106) is conclusive. *Dobson v. Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231.⁴ In any event, however, upon the record it is difficult to perceive how any other conclusion could have been reached. Taxpayer rests the asserted contract (Pet. 27-28) upon three papers consisting of: (a) the letter of October 14, 1935, from Mr. Bonbright to Colonel Perry; (b) Colonel Perry's telegram to Bonbright of October 16, 1935; and (c) the merger agreement, dated December 12, 1935 (see Statement, *supra*, pp. 3-6). The Tax Court was justified in finding that the letter and telegram were not corporate acts, but merely communications based on personal interest, from one stockholder and creditor of Boltin, Inc. to another, respecting the proposed merger of that company into its subsidiary, the taxpayer. The letter of October 14th is written on the personal stationery of Bonbright, its author, and is signed by him as an individual (R. 32-34). Intrinsically it evidences negotiations between these individuals in support of their personal interests,

⁴ The court below wrote no opinion and there is accordingly no basis for taxpayer's claim (Pet. 9-10) that the *Dobson* case has been erroneously construed by the court below to deprive taxpayer of a review on a question of law.

as stockholders, and not on behalf of or in the interest of any corporate entity. Indeed, the resolution of taxpayer's directors, adopted August 14, 1936 (see Statement, *supra*, p. 6) (R. 105-106), refers, in so many words, to the letter of October 14, 1935, as "the stockholders' agreement of October 14, 1935".⁵ The merger agreement (R. 105) contains no word on the subject of dividends, and neither court below can fairly be claimed to have erred in holding that it did not constitute an express restriction of dividends executed by taxpayer.

A stockholders' agreement is not a corporate promise, and had Perry, Bonbright or Rogers sold their shares, neither the new stockholders nor taxpayer corporation would have been bound by any restriction on the declaration of dividends (see R. 106-107). Compliance with the statute requires an enforceable corporate contract (*Central West Coal Co. v. Commissioner*, 132 F. 2d 190, 192 (C. C. A. 7th), certiorari denied, 318 U. S. 778, and Treasury Regulations 94, Article 26¹-2 (b), Appendix, *infra*, pp. 20-24), not a mere stockholders' agreement. The decision of the Ninth Circuit Court of Appeals in *Anglim v. Acme Brew-*

⁵ If for no other reason, this resolution cannot, of course, itself constitute a contract within the statute, since it was made subsequent to May 1, 1936, the crucial date under Section 26 (c) (1) (Appendix, *infra*, pp. 16-17).

ing Co., 143 F. 2d 412, rendered since the decision in the instant case, is directly in point and in accord with the decision below. To the same effect are *Monarch Theatres, Inc. v. Helvering*, 137 F. 2d 588 (C. C. A. 2d); *Phebus Oil Co. v. Commissioner*, 134 F. 2d 217 (C. C. A. 5th); and *Little John Coal Co. v. Smith*, 135 F. 2d 666, 667 (C. C. A. 7th).

Automotive Parts Co. v. Commissioner, 134 F. 2d 420 (C. C. A. 6th) (Pet. 9, 23) does not conflict with the holding in this case. There the only issue was whether, on the one hand, an exchange of writings was sufficiently definite to constitute a written and enforceable contract, or whether, on the other hand, it amounted merely to preliminary negotiation. Whether contract or negotiation, the correspondence there was between the corporation as such and the creditor; and not as here, only between stockholders of a parent corporation. Thus, the issue in this case was not before the court in the cited case and was not there decided (see R. 107). The decision of the Eighth Circuit Court of Appeals in *Harding Glass Co. v. Commissioner*, 142 F. 2d 41, is also not in conflict, for there the principal issue was one of construction of the terms of a contract concededly made by the taxpayer corporation; here, on the other hand, the question is whether taxpayer ever made a contract at all.

CONCLUSION

For the reasons above given, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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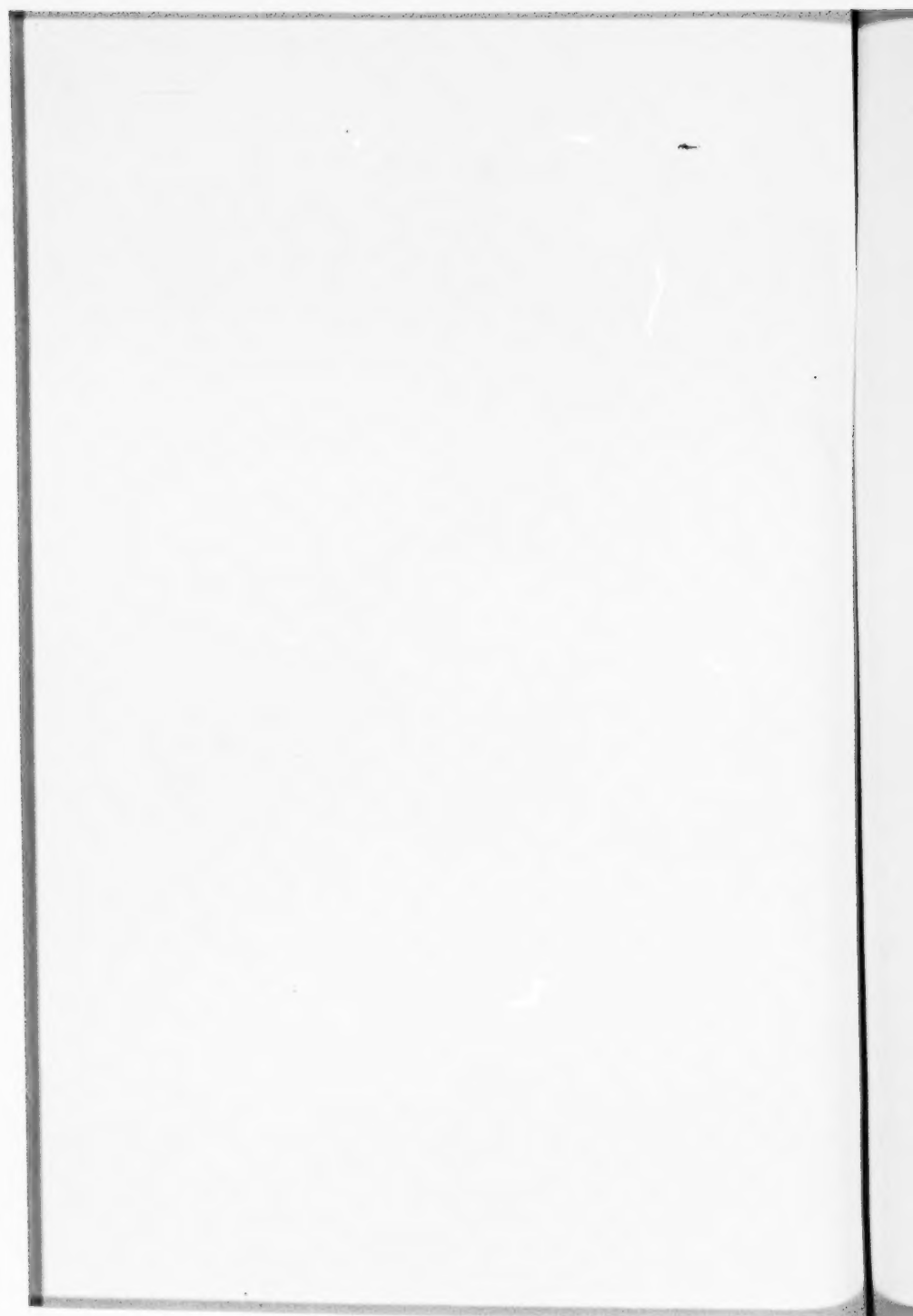
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WALTER J. CUMMINGS, Jr.,

Attorney.

SEPTEMBER 1944.





APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 14. SURTAX ON UNDISTRIBUTED PROFITS.

(a) *Definitions.*—As used in this title—

(1) The term “adjusted net income” means the net income minus the sum of—

(A) The normal tax imposed by section 13.

(B) The credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

(C) In the case of a holding company affiliate (as defined in section 2 of the Banking Act of 1933), the amount allowed as a credit under section 26 (d).

(D) In the case of a national mortgage association created under Title III of the National Housing Act, the amount allowed as a credit under section 26 (e).

(2) The term “undistributed net income” means the adjusted net income minus the sum of the dividends paid credit provided in section 27 and the credit provided in section 26 (c), relating to contracts restricting dividends.

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation a surtax equal to the sum of the following, subject to the application of the specific credit as provided in subsection (c):

7 per centum of the portion of the undistributed net income which is not in excess of 10 per centum of the adjusted net income.

12 per centum of the portion of the undistributed net income which is in excess of 10 per centum and not in excess of 20 per centum of the adjusted net income.

17 per centum of the portion of the undistributed net income which is in excess of 20 per centum and not in excess of 40 per centum of the adjusted net income.

22 per centum of the portion of the undistributed net income which is in excess of 40 per centum and not in excess of 60 per centum of the adjusted net income.

27 per centum of the portion of the undistributed net income which is in excess of 60 per centum of the adjusted net income.

* * * *

SEC. 26. CREDITS OF CORPORATION.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * *

(c) *Contracts Restricting Payment of Dividends.*—

(1) *Prohibition on Payment of Dividends.*—An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more cred-

its are equal in amount only one shall be taken into account.

(2) *Disposition of Profits of Taxable Year.*—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word "debt" does not include a debt incurred after April 30, 1936.

(3) *Double Credit Not Allowed.*—If both paragraph (1) and paragraph (2) apply, the one of such paragraphs which allows the greater credit shall be applied; and, if the credit allowable under each paragraph is the same, only one of such paragraphs shall be applied.

Revenue Act of 1942, c. 619, 56 Stat. 798:

SEC. 501. ADDITIONAL CREDITS FOR UNDIS-
TRIBUTED PROFITS TAX.

(a) *Amendments to the Revenue Act of 1936.*—

(1) Section 14 (a) (2) of the Revenue Act of 1936 (relating to definition of undistributed net income) is amended to read as follows:

"(2) The terms 'undistributed net income' means the adjusted net income minus the sum of (A) the dividend paid credit provided in section 27, (B) the credit provided in section 26 (c) relating to restrictions on payment of dividends, (C) except in cases where section 26 (c) (1) is applicable, the deficit credit provided in section 26 (f), and (D) the redemption credit provided in section 26 (g)."

(2) Section 26 (c) of the Revenue Act of 1936 (relating to credits of corporations) is amended by amending the heading to read as follows: "(c) *Restrictions on Payment of Dividends.*—"; and by amending paragraph (3) to read as follows:

"(3) *Deficit Corporations.*—In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936.

"(4) *Double Credit Not Allowed.*—If more than one of the credits provided in the foregoing paragraphs (1), (2), and (3) apply, then the paragraph which allows the greatest credit shall be applied; and, if the credit allowable under each paragraph is the same, only one of such paragraphs shall be applied."

(3) Section 26 of the Revenue Act of 1936 (relating to credits of corporations) is amended by adding at the end thereof the following new subsections:

“(f) *Deficit Credit*.—The amount by which the adjusted net income exceeds the sum of (1) the earnings and profits accumulated after February 28, 1913, as of the beginning of the taxable year, and (2) the earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year). For the purposes of this subsection, earnings and profits of the taxable year shall be computed without diminution by the amount of the tax imposed under section 14, 102, 103, or 351 for such taxable year; and earnings and profits accumulated after February 28, 1913, as of the beginning of the taxable year, shall be diminished on account of the tax under section 14, 102, 103, or 351 for any previous taxable year only by the amount of such tax as computed under the amendments made by section 501 of the Revenue Act of 1942.

“(g) *Stock Redemption Credit*.—An amount equal to the portion of the recognized gain, realized within the taxable year and prior to March 3, 1936, from the sale or other disposition of a capital asset, which, pursuant to a contract, was distributed prior to such date to shareholders in redemption in whole or in part of preferred stock and which is not otherwise allowable as a credit under any other provision of this section or section 27.”

(b) *Effective Date of Amendments*.—The amendments made by subsection (a) shall be effective as of the date of the enactment of the Revenue Act of 1936.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

Art. 14-1. [As amended by T. D. 5263, 1943 Cum. Bull. 1003] **SURTAX ON UNDIS-
TRIBUTED PROFITS OF CORPORATIONS.**—In gen-
eral, the Act imposes a surtax on the net
income of corporations in an amount
measured by the undistributed net income.
The rates of surtax are graduated in
brackets, the lowest rate being 7 percent
of that portion of the undistributed net
income not in excess of 10 percent of the
adjusted net income and the highest rate
being 27 percent of that portion of the
undistributed net income which is in excess
of 60 percent of the adjusted net income.

The adjusted net income is defined in
section 14 (a) (1) as the net income (see
section 21) minus the sum of (1) the nor-
mal tax imposed by section 13 and (2) the
credit provided in section 26 (a), relating
to interest on certain obligations of the
United States and its instrumental-
ities. * * *

The undistributed net income is defined
in section 14 (a) (2) as the adjusted net in-
come minus the sum of (a) the dividends
paid credit provided in section 27 (see
articles 27 (a)-1 to 27 (h)-1, inclusive), (b)
the credit provided in section 26 (c), re-
lating to restrictions on payment of divi-
dends (see article 26-2 (c)), except where
section 26 (c) (1) is applicable, the deficit
credit provided in section 26 (f) (see
article 26-4), and (d) the redemption credit
provided in section 26 (g) (see article
26-5).

Art. 26-2. [As amended by T. D. 5263,
supra] **CREDIT IN CONNECTION WITH RESTRIC-
TIONS ON PAYMENTS OF DIVIDENDS.**—

(a) The credit provided in section 26 (c)
with respect to the restriction on the pay-

ment of dividends is not available under every contractual or statutory prohibition which might operate to restrict the payment of dividends, but only with respect to those provisions of a written contract, a law, or an order of a public regulatory body, as the case may be, which satisfies the conditions prescribed in the Act. The charter of a corporation does not constitute a written contract executed by the corporation within the meaning of section 26 (c). The restrictive provisions recognized by the Act are of three general types, as follows:

(1) Those which come within section 26 (c) (1), in that they prohibit or limit the payments of dividends during the taxable year;

(2) Those which come within section 26 (c) (2), in that they require the payment, or irrevocable setting aside, within the taxable year, of a specified portion of the earnings and profits of the taxable year for the discharge of a debt incurred on or before April 30, 1936; and

(3) Those which come within section 26 (c) (3), in that they prohibit the distribution of dividends during the existence of a preexisting deficit in earnings and profits.

If a corporation is restricted with respect to the payment of dividends by two or more contract provisions coming within section 26 (c) (1), only the largest of the credits computed with respect to each of such provisions, and not their sum, shall be allowable under section 26 (c) (1) and, for such purpose, if two or more credits are equal in amount, only one shall be taken into account. However, section 26 (c) (4) provides that if more than one of the credits

provided in section 26 (c) (1), section 26 (c) (2), and section 26 (c) (3) apply, then the paragraph which allows the greatest credit shall be applied; and, if the credit allowable under each paragraph is the same, only one of such paragraphs shall be applied.

(b) *Prohibition on payment of dividends.*—The credit provided in section 26 (c) (1) is allowable only with respect to a written contract executed by the corporation prior to May 1, 1936, which expressly deals with the payment of dividends and operates as a legal restriction upon the corporation as to the amounts which it can distribute within the taxable year as dividends. If an amount can be distributed within the taxable year as a dividend—

(1) in one form (as, for example, in stock or bonds of the corporation) without violating the provisions of a contract, but can not be distributed within the taxable year as a dividend in another form (as, for example, in cash) without violating such provisions, or

(2) at one time (as, for example, during the last half of the taxable year) without violating the provisions of a contract, but can not be distributed as a dividend at another time within the taxable year (as, for example, during the first half of the taxable year) without violating such provision—

then the amount is one which, under section 26 (c) (1), can be distributed within the taxable year as a dividend without violating such provisions.

The credit provided in section 26 (c) (1) is equal to the excess of the adjusted net income, as defined in section 14 (a), over

the aggregate of the amounts which can be distributed within the taxable year without violating the provisions of such contract. The requirement that the provisions of the contract expressly deal with the payment of dividends is not met in case (1) a corporation is merely required to set aside periodically a sum to retire its bonds, or (2) the contract merely provides that while its bonds are outstanding the current assets shall not be reduced below a specified amount. * * *

(c) *Disposition of profits of taxable year.*—Under the provisions of section 26 (c) (2), a corporation is allowed a credit in an amount equal to that portion of the earnings and profits of the taxable year which, by the terms of a written contract executed by the corporation prior to May 1, 1936, and expressly dealing with the disposition of the earnings and profits of the taxable year, it is required within the taxable year to pay in, or irrevocably to set aside for, the discharge of a debt incurred on or before April 30, 1936. The credit is limited to that amount which is actually so paid or irrevocably set aside during the taxable year pursuant to the requirements of such a contract.

Only a contractual provision which expressly deals with the disposition of the earnings and profits of the taxable year shall be recognized as a basis for the credit provided in section (c) (2). A corporation having outstanding bonds is not entitled to a credit under a provision merely requiring it, for example, (1) to retire annually a certain percentage or amount of such bonds, (2) to maintain a sinking fund sufficient to retire all or a certain percent-